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Value investment and Market timing: Opportunities in times of crises

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He has held senior positions across some of Malaysia's key financial institutions, including the Arab-Malaysian Merchant Bank (AMMB), now AmInvestment Bank Bhd where he developed and launched Arab-Malaysia Gilts – the first unit trust in Malaysia to invest solely in government and bank-backed securities. He was also actively participating in launching The Malaysia Fund Inc, the first Malaysian closed-end country fund managed by Morgan Stanley and listed on the NYSE in 1987.

Named "Southeast Asia's Small-cap King" by Bloomberg and "King of the Second Board" by the local media, 35-year industry stalwart Dr Tan Chong Koay is known for his acute sense of major market timing and stock selection At a recent seminar organised by SMU's Centre for Asset Securitisation and Management in Asia (http://www.smu.edu.sg/institutes/skbife/centres/casa/index.asp), Tan shared his investment approach: a solid understanding of the company's management team, strong balance sheets with low gearing and good cash flows; positive earnings dynamic, capable and focused management supported by dominant market positioning; and of course, attractive financial ratios.

Look before you leap

Tan makes it a point to always to meet with the CEO or CFO of potential investees to hear, first-hand, ideas and plans. If he likes what he hears, he follows up with the necessary due diligence and third party checks, before taking an investment action. For him, investments are not just about the numbers, but also the people behind the numbers: Do they have integrity? Are they capable? Are they focused? In addition to that, operational transparency and good corporate governance will underscore the overall viability of an investment.

For example, Tan was an early investor in Singapore-listed water treatment firm Hyflux before its initial public offering. According to him, Tan got sold on Hyflux after he was sufficiently impressed by the focus and drive of the company's top management. Tan, however, was a tad rueful for selling off his shares in Hyflux too early, when it was trading at 20 times earnings – relatively lofty by the broader market's measure. It then went as high as 40 times not long after. Nevertheless, his experience dealing with the management reinforced his belief that investing is also an art, and not just science, and that knowing the company's management well will certainly help shape a successful investment decision.

Next, besides the fundamental value, *timing* is important too. Tan admits that his best investments are a result of successful market timing and it has happened more than once. Recounting past crises like Black Monday in 1987, up to the 2008 sub-prime crisis, one means by which he would assess the market is to watch out for news of government interventions in the markets and other negative news. Headlines like "Confusion remains in market" might be a signal that over-bearishness has taken over and that being contrarian might prove profitable. When the 1987 crash took place, the Hong Kong bourse was closed for three days and traders in the Kuala Lumpur Stock Exchange -- not yet in the "scripless" trading systems of today -- were asking for an immediate delivery of scripts.

"Beauty of a crash"

If there is something the investment community likes other than making money, it is visibility and some level of certainty. "The market never likes surprises", said Tan. When surprises occur, the tendency is to over-react. Being 65% in cash before "Black Monday" enabled him to seize the opportunity to load up and to profit soon after, helping AMMB win the top manager accolade for the year 1987. "The beauty of a crash is that you get to buy good shares at bad prices," said Tan. This was his first experience with a major crisis as a fund manager, and it buoyed his confidence in the value investing methodology.

Tan saw similar signs during the 1997 Asian financial crisis, and again in 2000, when the dot-com induced technology bubble burst. Pessimistic headlines matched negative investor sentiments, spooking even old hands in this business. Seized by fear and driven by confusion, many investors sold near the bottom, never mind if the shares are good or bad; short term knee-jerk decisions prevailed over long term fundamentals. "During boom times, investors are generally over optimistic. When the trend reverses, investors are normally ultra pessimistic", he said. "Emotion overtakes rationality. Equities will outperform cash when the market or shares are selling at great discounts."

Tan explained why he believes, especially in times of crisis, in the common dictum, *cash is king*: "Keeping cash when the equity market is at the extreme low is not a good alternative, as chances of equities outperforming cash improve significantly." The benefit of having cash is to be able to deploy it in drastically undervalued opportunities, he said.

The big breaks

While some of the world's most renowned investors and fellow value investors whom he admires, such as Peter Lynch of Fidelity Investments, have denounced 'market timing', calling it a waste of mental energy, Tan still considers major markets timing to be crucial. "I need a crash to do well," he said.

It was Tan's personal experience that made him say so. Pheim's first big break, as a firm, came just before the Asian financial crisis in 1997. With 25% of a major portfolio loaded with small cap stocks valued at half the market average, the firm managed to reap multi-baggers on KLSE second board names such as Geahin Engineering (renamed Maxbiz Corporation) and Bridgecon Holdings. Others, like PT Tempo Scan and Dialog, rose 14 and 9 times respectively over the crisis.

Now, not every stock market player can have the courage to plough in when everybody else is selling. There is always the element of risk but savvy investors will know how to assess their chances. "If you want to make money, you need to take calculated risks, and you do not want the market to function efficiently and perfectly. If you believe the equity market is efficient, you will never be a star," said Tan. However, attempts to time the market perfectly might be futile too. "Trying to buy the shares at the lowest price and sell at the highest is unrealistic," he said, and after careful study of the company's fundamentals and making that crucial 'buy' decision, "investors need patience to wait for the companies to prove themselves" – and to allow the price to move up to its fair value.

Ups, downs and turnarounds

To be sure, Tan did not have an uninterrupted run. Pheim (http://www.pheim.com.sg/homepage.asp) had its share of tough times between 2004 and 2005, when its ten-year winning streak of beating benchmarks was broken. Despite a generally buoyant market then, small cap stocks were out of favour and they suffered losses. Pheim's underperformance, in turn, undermined its ability to attract new funds. However, Tan stuck to value investing – the philosophy that has served him well over the decades -- and the firm soon put those days behind.

In the more recent 2008 global financial crisis, Tan managed to yield some solid returns on Indonesian plantations plays, like PT Astra Agro and PT London Sumatra, which made three to four times. At the most extreme point of the crisis, PT Astra Agro, which, in Tan's opinion, was Indonesia's best plantation company, was only trading at 2-3 times its price-earnings multiple, and with no debt gearing.

For his astute major market timing and stock picking, Tan received a series of awards like the '2010 CEO of the Year for Malaysia' bythe Hong Kong-based Asia Asset Management, '2010China Top 10 Financial Intelligent Persons Awards' and '2010 APEA (Asia Pacific Entrepreneurship Awards) Outstanding Entrepreneurship Awards'. Despite all these awards, Tan's most satisfying accolade was being the Chief Strategist of Pheim ASEAN Emerging Companies Growth Fund Ltd. This fund was ranked No.1 by Morningstar, within the category, ASEAN Equity Funds, in terms of total returns in US dollars, for all 1- to 15-year periods as of December 2010.

With a long and consistent track record, Pheim has come a long way. Pheim Asset Management (Asia) Pte Ltd (Pheim Singapore) and Pheim Asset Management Sdn. Bhd. (Pheim Malaysia) together now manage some US$1.8 billion worth of assets. In concluding the talk, Tan emphasised that investment success comes when one seeks out value investing opportunities and strikes at the right time. At all times, the right time comes in times of crises.

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